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THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT—A NEW DEPARTURE IN INTERNATIONAL FINANCE

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Early in World War II, financial and economic experts of the Allied Nations concluded that if economic health was to return with the peace, the family of nations would have to forego the bad economic manners which had become commonplace between the wars. The conviction that a new and better economic household for the world had to be planned resulted in the United Nations Monetary and Financial Conference at Bretton Woods, New Hampshire, in July, 1944, in which representatives of 44 nations participated.

The Conference met to solve two major problems. The first of these grew out of the chaotic foreign exchange practices which had characterized the 1930's. The Conference's answer to it was the International Monetary Fund, a new international institution designed to stabilize international exchange, to hasten the removal of artificial barriers to international payments, and to provide short-term foreign exchange assistance to members to overcome temporary disequilibrium in their balance of payments.

The Conference's second problem was to find a way to revive the international capital investment which would be needed to help reconstruct what the war had destroyed and to accelerate an increase in productivity and in living standards in the undeveloped areas of the world. The International Bank for Reconstruction and Development (popularly known as the World Bank) was designed as the answer to that problem.

Now, as the Bank is approaching the second anniversary of the commencement of its activities, it may be of value to analyze the basic conceptions underlying the establishment of the Bank and, against that background, to review the actual developments in its organization and operations.

BASIC CONCEPTIONS

There have been, traditionally, two principal types of international financing: private investment and inter-governmental loans. The Bretton Woods Conference regarded both as inadequate, by themselves, for the needs of the post-war period.

Inter-governmental financing was considered as necessary to meet im-

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mediate relief and rehabilitation needs, as in the case of UNRRA, but it was properly regarded as too inflexible, too spasmodic, too beset with political considerations, to be appropriate for purposes of long-range reconstruction and development. On the other hand, the Conference recognized that, at the conclusion of the war, the need for international financing would be so large, and the risks so great, that private capital would not be available in the sizeable amounts required without some form of governmental guarantee. A new type of international investment mechanism was therefore regarded as essential which would provide the guarantee necessary to start the flow of private capital and which would avoid, on the one hand, the political motivation and vagaries of inter-governmental credits, and, on the other, the frequent misdirection of private international financing.

There are two unique features of the Bank which make it well equipped to serve these purposes. The first is the nature of the Bank's capital structure, and the second is the nature of the Bank's mission. Each of these features deserves brief examination.

The authorized capital stock of the Bank is $10,000,000,000, divided into 100,000 shares of the par value of $100,000 each. The shares may be subscribed only by member governments of the Bank and are transferable only to the Bank. As of April 1, 1948, the total subscribed capital of the Bank was $8,263,100,000. The largest single subscription is that of the United States, which amounts to $3,175,000,000, about 34 per cent of the total.

Each member's total subscription is divided into three parts:

(1) Two per cent of each member's subscription is payable in gold or United States dollars. This part of the Bank's capital is freely available for use in its operations. It amounted to $160,347,000 on April 1, 1948, not including authorized deferments of $4,915,000.

(2) 18 per cent of each subscription is payable in the currency of the respective members. Because it was expected that for some time after the war most of the members of the Bank would not be in a position to permit the export of capital, this 18 per cent portion of the Bank's capital is available for loans only with the consent of the member whose currency is involved. The United States has given its approval to the use for lending purposes of the 18 per cent of its subscription, amounting to $571,500,000. To date the only other country which has given such approval is Belgium, which has permitted the use of the equivalent of $2,000,000 of the 18 per cent of its subscription which was paid in Belgian francs.

(3) The remaining 80 per cent of each member's subscription is subject to call only if and when required to meet the obligations of the Bank. When any call on the 80 per cent of the subscription is made, it is payable, at the option of the member, in gold, in United States dollars, or in the currency

required to discharge the obligations to meet which the call is made. This 80 per cent of the capital is in the nature of a guaranty fund and is not available for use in the lending operations of the Bank.

Since the need today is primarily for United States dollars and since only the United States has given permission to the Bank to use its full 18 per cent for loans, the immediately available loanable resources of the Bank derived from its capital amount to only about $730,000,000. For loanable funds in excess of this amount, the Bank must rely on the sale of its bonds to private investors.

Thus, although the Bank is an inter-governmental organization, the nature of its capital structure ties it directly into the private investment community. This reliance of the Bank on the private money market for the major portion of its loanable funds is one of its cardinal elements of strength. For one thing, it keeps the Bank close to economic realities, for despite the protection provided by the 80 per cent unpaid portion of the capital subscription of members, private investors will not entrust their money to the Bank unless they are convinced that it follows sound lending practices. For another thing, it relieves the Bank of pressures to which it might otherwise be subject to make loans for relief purposes or for political purposes, for it is generally understood that if the Bank should ever embark on such a course, its ability to borrow, and therefore to lend, would be at an end.

The unique nature of the Bank's mission is more subtle and less widely understood than the unique nature of its capital structure, but it is just as important. The distinguishing feature in this respect consists of the considerations which motivate the Bank's activities.

The motive for private international investment is the desire to earn as large a profit in as short a time as possible. This profit motive is entirely proper; it has been, and will doubtless continue to be, the moving force behind the development of most of the civilized world. But, because the investment of private capital is motivated by the desire for profit, such investment will always tend to be directed into those particular enterprises which provide the greatest financial returns, whether or not those enterprises also provide the greatest social and economic benefits to the communities in which they are located. The development of mines and factories, for example, is apt to be favored by private investors over the financing of such public capital facilities as roads, port facilities, irrigation and reclamation projects and the like. As a result, economic development which relies solely upon the initiative of foreign private capital is likely to be unbalanced, viewed from the standpoint of the country under development.

The motive for inter-governmental lending is quite different. In this case, the objective of the lending government is properly the advancement of its own political and economic interests, and its lending operations are conducted accordingly. Strategic considerations of all sorts are apt to be given at least as much weight as the inherent economic soundness of any proposed loans.

The Bank, by reason of its nature as a cooperative international organization, independent of any outside control, is motivated neither by the desire to make large profits for its stockholders nor by the desire to gain political influence or prestige. Its only purpose is to help its member countries to reconstruct or develop their economies along proper lines by making sound and realistic loans. Thus, the Bank's investments are not limited to those enterprises which promise an attractive direct financial return; indeed, the emphasis is rather on helping to provide the framework of public utilities and key industries which may require too heavy an initial outlay and may not be directly remunerative enough to attract private investment. Such investments serve as a base for further development and as an inducement to the inflow of private capital. On the other hand, the Bank does not make loans solely on a showing of need; the applicant country must satisfy the Bank that the money will be devoted to useful and productive projects, and that the country's economic position and policies are such as to present a satisfactory prospect of repayment.

The objective, non-political character of the Bank's activities is important from the standpoint of assuring investors in the Bank's bonds that its resources will not be dissipated in uneconomic loans. Even more important, however, it serves to assure the borrowing countries that the Bank's insistence upon practical, productive projects and upon the adoption by them of sound economic policies derives from the Bank's desire to help them strengthen and stabilize their economies and not from any desire to exploit their resources. This gives the Bank a singular opportunity to be of service in promoting the economic growth of its members.

Whether the Bank will be able to capitalize fully upon that opportunity, it is still too early to judge. But a review of current developments in the Bank's organization and in its lending and borrowing activities will indicate the direction in which the Bank is moving and permit appraisal of the progress it has made to date.

ORGANIZATION

The Bank's organization consists of:

(1) A Board of Governors composed of one governor appointed by each member and an alternate for each governor.

(2) A Board of Executive Directors composed of 14 members, of whom five are appointed by the five largest stockholders (the United States, the

United Kingdom, France, China, and India) and nine are elected by the remaining members. Each Executive Director also has an alternate.

(3) The President, who is elected by the Executive Directors, and an international staff appointed by the President. As of April 1, 1948, this staff numbered 419 persons of 23 different nationalities.

Under its Articles of Agreement all the powers of the Bank are vested in the Board of Governors, which may designate and has delegated such powers (with certain exceptions) to the Executive Directors.* The Governors meet only once a year, although special meetings may be called if necessary.

The Board of Executive Directors and the international staff are, for practical purposes, the important organs of the Bank. The Articles specify that "the Executive Directors shall function in continuous session," and it was apparently assumed that they would initiate all policy decisions and oversee operations in rather detailed fashion. Gradually, however, there has emerged a different conception of the Executive Directors' responsibilities and of their relationship with the staff, which not only is more in keeping with the Bank's non-political character but also increases its ability to function effectively.

In essence, under the present division of responsibility, the staff makes an initial analysis of all loan proposals or other policy questions, and presents its considered conclusions and recommendations for approval by the Executive Directors. The latter, of course, make the final decision on all important matters, but they do so on the basis of a single integrated recommendation which has emerged from careful collection and organization of the available facts, objective analysis of alternative courses of action, and in most cases extensive discussion with the country concerned.

Such a specific staff recommendation greatly limits the likelihood that decisions will be made on political grounds or as a result of compromises among the various national representatives. In the first place it sets an objective, non-political tone for the Board's discussions and makes it hard for any member to introduce political considerations. Second, it minimizes the pressure on any national representative to take an extreme position in order to balance or forestall advocacy of an opposite extreme by the representatives of other nations. Third, since it is an integrated recommendation—in which, for example, the reasons, purposes, amount, terms and conditions of a loan are tied together—there is little room for bargaining or making deals. No staff

* The exceptions include the admission of new members, the increase or decrease of the capital stock of the Bank, the suspension of a member, decisions on appeals from interpretations of the Articles of Agreement of the Bank made by the Executive Directors, approval of agreements with other international organizations, and decisions with regard to the distribution of the net income of the Bank and the liquidation of the Bank.

recommendation on any fundamental question has yet been rejected, and in the light of the existing relationship between staff and directors, such a step would not be taken lightly.

On the other hand, consider what the situation would be if proposed loans were brought directly to the Executive Directors and discussed by them before they had been fully analyzed by the staff. Suppose, for example, that Ruritania applies for a development loan of $200 million. The issues involved are necessarily complicated, requiring judgments not only as to the value of the projects proposed, but also as to the general economic position and policies of Ruritania, its prospective balance of payments, the probable effect of the proposed loan on its internal economy and its foreign trade, the world market for the products to be developed, and so on. In the absence of a detailed objective analysis of these factors, the decision whether Ruritania should be granted a loan, how much it should be, and what terms and conditions should be required, could be made only on the basis of the various national attitudes toward Ruritania. The Executive Director representing Ruritania would have to line up support among his colleagues, perhaps by agreeing in advance to endorse their applications in return. The staff would increasingly be by-passed, and their advice disregarded, as these reciprocal commitments mounted up. In the end, no doubt, a series of compromises would be worked out; Ruritania would get, say, $50 million of the $200 million requested, and various sums would be allotted to other countries as seemed necessary to avoid undue controversy. But such compromises would certainly not reflect accurately the economic realities of the situation.

The very different kind of Board-staff relationship which has in fact developed in the Bank has justified itself in practice. In no decision of the Board so far has there been any dissent; the Executive Directors have shown an unusual unity of viewpoint. In part, of course, this may be attributed to the fact that the Directors are themselves primarily financial experts rather than politicians, men who have a good basic understanding of, and sympathy for, the Bank's problems and objectives. In part also it reflects the confidence of the Executive Directors in the staff of the Bank—in its technical competence, in its objectivity and in its loyalty to the Bank.

It should be emphasized that the Executive Directors are by no means a rubber stamp. In general they function like the Board of Directors of any corporation, except that their contacts with the staff are more intimate and they play an important role as interpreters of the Bank's views to their countries and of their countries' views to the Bank. The Executive Directors meet normally once a week and are kept informed of all important current operations. As individuals they are also consulted informally by the staff on all sorts of matters, including technical questions as well as matters involving the countries which they represent. Their judgment and diverse experience are valuable assets to the Bank. Even more important, their intimate knowledge of the Bank's policies and operations enables them to serve as valuable conduits between the Bank and the governments they represent; they help greatly to establish the close working relationship between the Bank and its members which is so important to its success.

The organization of the Bank as it has developed indicates that there is nothing inherent in the nature of an international agency which is incompatible with the effective, business-like conduct of its affairs. If further proof of this be needed, however, it is provided by the record of the Bank's lending and borrowing operations.

Lending Operations

In its lending operations, the Bank necessarily gave initial priority to the needs of European reconstruction. That task was most urgent not only from the standpoint of Europe itself but also from that of the rest of the world. Europe had a great productive plant and a reservoir of trained workers already in being. To put them to work and keep them at work by furnishing the necessary fuel, raw materials and replacement equipment was clearly the quickest and most economical way to raise the level of world output.

The situation, too, was an emergency one. The European nations, as a result of hard work, considerable sacrifice and substantial foreign aid, had made great progress in recovery from the devastating effects of the war. They still had not reached the point, however, where they could continue to progress through their own unaided efforts; they needed additional foreign assistance if they were not to slip back into collapse and disintegration. The management of the Bank considered, and the Executive Directors were in unanimous agreement, that to prevent such a regression was a matter of prime importance to all the members of the Bank. For without a revival of European production, the world's requirements for manufactured goods could not be fully supplied; without the recovery of Europe as a market, the export trade of Africa, Asia and the Western Hemisphere would be disastrously curtailed; without the restoration of stable and convertible European currencies, other countries would find it increasingly hard to finance their trade; and without all these things, realization of the hopes and plans for economic stability and the healthy development of the world's productive potentialities would be immeasurably more difficult and long delayed.

Accordingly, the first four loans of the Bank, all granted in 1947, were made to European nations—$250 million to France, $195 million to the Netherlands, $40 million to Denmark and $12 million to Luxembourg—a total of $497 million.

The initial priority given to European requirements did not, however, divert the attention of the Bank from consideration of the needs of the rest of its members. Indeed, with the enactment by Congress of the European Recovery Program, the Bank regards Latin America, Asia, Africa and the Middle East as presenting it with the greatest opportunity to render constructive assistance.

In March, 1948, the first development loans were granted. These were credits aggregating $16 million to Chile to finance the development of hydroelectric power and agricultural production. In addition, as of April 1, 1948, the financing of proposed projects in more than 20 other countries outside of Europe was the subject of discussions in various stages, ranging from merely preliminary exploratory talks to active and advanced negotiations.

There are several aspects of the loans which have been granted to date which, because they have not been usual in international investment, deserve brief mention:

(a) All of the loans are earmarked for definite productive purposes. Thus, each of the loan agreements provides for the purchase of specific goods or services which the borrowing country needs to get production going, such as industrial and agricultural machinery, transport equipment and basic raw materials. None of the proceeds of the loan may be used for the purchase of any goods of a non-productive character.

(b) Under the terms of the loan agreement, advances are made to the borrower only upon presentation by it of satisfactory documentary evidence that the amount advanced will be applied to the purchase of goods or services of a type covered by the agreement. In the usual case, payment is made against invoices.

(c) Arrangements are made whereby representatives of the Bank in the borrowing country supervise the end use within the borrowing country of the goods purchased with the proceeds of the loan, in order to assure that such goods are actually used for the purposes for which intended.

(d) The borrower agrees to furnish the Bank with full information not only concerning the use made of the loan but also concerning industrial and economic conditions in its territories. It further agrees to consult with representatives of the Bank on all matters of mutual interest and to give due consideration to any suggestions which the Bank may care to make.

(e) The borrower also agrees that it will advise the Bank, and afford the Bank a reasonable opportunity to express its views, with regard to any assumption of additional external debt or any proposals which would modify the terms of payment of any existing external debt.

These features of the loan agreements reflect two of the basic policies of the Bank. The first is insistence that the use of the proceeds of all loans shall be carefully supervised, so that both lender and borrower may know how the money is being applied and what benefits it is accomplishing. Money carelessly furnished or carelessly accounted for usually has poor consequences and this is particularly true of international investment. The procedures adopted by the Bank should serve to avoid this danger.

The second basic policy reflected by these provisions of the loan agreements is insistence upon recognition that the soundness and productivity of any international loan depends not only upon the character of the program or project which is financed but also upon the over-all economic position and policies of the borrowing country. Before a loan is granted by the Bank, a thorough examination is made, usually including an on-the-spot investigation, of all aspects of the borrowing country's economy. Where economic or financial reforms are believed to be necessary, the borrowing country is so advised and the grant of the loan may be conditioned upon the concurrent adoption by such country of an appropriate program for financial stability. Furthermore, since repayment of the loan depends upon continuance of sound economic policies by the borrowing country, the Bank insists upon being kept informed throughout the life of the loan of all important developments and upon the right to consult with representatives of the government with respect thereto.

The Bank's lending standards are high; some impatient idealists think they are too high. But the interests of the Bank's borrowers, no less than those of investors in the Bank's securities, would be ill-served by poorly planned, unproductive loans. At best such loans are likely to be palliatives—like patent medicines which have a temporary pain-killing or stimulating effect but which bring no lasting benefit and often disguise or even aggravate the basic disease. In the end bad loans leave behind only disillusionment, debt and ill will. Most countries have had unhappy experiences with financing of this type at some time in their history. The Bank cannot properly fulfill the purposes for which it was established unless its lending operations serve to minimize such experiences in the future.

Borrowing Operations

Under its Articles the Bank may borrow funds for use in making loans only with the approval of the member in whose markets the funds are to be borrowed. At the present time the United States market is the only one in which the Bank can borrow any substantial sums. It is, of course, desirable that the Bank's bonds shall have as wide a distribution as possible. At the same time it is obvious that the Bank will have to look chiefly to the large institutional investors such as insurance companies, banks and others which customarily invest in prime securities, in order to distribute the large amounts of bonds which the Bank will have to offer.

On July 15, 1947, the Bank made the first public offering of its bonds in the United States market. The offering consisted of two issues: one of $100,000,000, principal amount, of Ten Year 2¼% Bonds, due July 15, 1957, and the other of $150,000,000 principal amount, of Twenty-Five Year 3% Bonds, due July 15, 1972. Both issues were priced at par. The bonds are general obligations of the Bank not secured by any pledge of specific collateral. They were registered with the Securities and Exchange Commission pursuant to the Securities Act of 1933, and listed on the New York Stock Exchange.

The Bank did not seek to have the offering underwritten by investment bankers. The two issues were, rather, sold through dealers on a commission basis, the commission being ½ of 1% for the Twenty-Five Year Bonds and ¼ of 1% for the Ten Year Bonds. Over 1,700 dealers throughout the country participated. The Bonds were sold to purchasers in all 48 states of the United States and in the District of Columbia and small amounts were sold to purchasers in other countries. Both issues were substantially over-subscribed.

Since investments by banks, insurance companies and similar institutions are regulated by law, it has been necessary in many states to obtain special legislation or administrative rulings in order to permit such institutions to purchase the Bank's securities. As of April 1, 1948, subject to various qualifications as to amounts and other conditions, the bonds were legal for investment in the United States as follows:

By commercial banks—in 39 states and the District of Columbia
By saving banks—in 21 states and the District of Columbia
By insurance companies—in 28 states *
For trust funds—in 28 states and the District of Columbia

Summary and Conclusion

When United States membership in the Bretton Woods institutions was first debated in the Congress of the United States, there was much uninformed anxiety on the part of many who prophesied that the Bank would be just a convenient device for foreigners to give away American money to other foreigners without American control. Not only has criticism of that variety disappeared almost entirely, but in connection with the United States Senate committee hearings on the European Recovery Program, Senator Vandenberg, after having listened to a description of the Bank's system of loan

* Included in these 28 states are 3 states in which legislation authorizing investment has been adopted but has not yet become effective.

supervision, commented: "If a system of that character could be at the base of ERP. . . . I think that half of the criticism of it would disappear."

Yet, as has been mentioned, the very prudence of the Bank's management has aroused criticism of an opposite kind. The most enthusiastic, if not the most realistic, supporters of the Bretton Woods institutions had expected the Bank to fashion the world in the image of Eden. When abundance did not make its scheduled appearance, they attempted to blame the small number of the Bank's loans for the delay. If only the Bank had done what it was meant to do, so they complained, ERP would not have been necessary. These criticisms overlook the fact that the Bank's character does not permit it to be a relief organization, and that the Bank's very existence is tied to the soundness of its loans. They also overlook the fact that the preparation of specific projects up to the point where they are ready for financing requires considerable time.

To date, the Bank has financed a new steel mill and new railroad equipment in Luxembourg; locomotives, steel rails, bridges and stocks of raw materials in France and Holland; agricultural and dairy equipment in Denmark; and electric power development and agricultural machinery in Chile. At the same time, the Bank has succeeded in gaining the confidence of important American investors. These are modest but solid achievements.

In the day-to-day work of the Bank nationalities are forgotten, and decisions on small and on important matters alike are made with the Bank's, and not with national interests in mind. The statement of the Articles of Agreement that the Bank's officials and staff "owe their duty entirely to the Bank and to no other authority" is descriptive rather than wishful. Thanks to that fact, the Bank has been able to prove that a cooperative of sovereign nations can be an efficient business unit with the capacity to take effective action.